In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1349

ESTATE OF BETTY BERRY, DECEASED, LOUIS BERRY, EXECUTOR, LOUIS BERRY, SURVIVING SPOUSE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

LCG TRUST NO. 2, A. R. GLANCY, JR., SUCCESSOR TRUSTEE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The only issue presented here is whether the Tax Court properly characterized as interest and therefore ordinary income a part of deferred installment payments that petitioners received as the sellers[1] of the Raleigh Hotel in Washington, D.C. The Tax Court

[1] Petitioners in addition include the estate of the deceased wife of one of the sellers, a party by reason of the filing of joint returns. In this memorandum "petitioners" refer only to the sellers.

265-042—67

rejected petitioners' contention that the deferred payments were entirely payments of principal and therefore capital gain (R. 114a–117a).[1] The court of appeals affirmed (Pet. 14–15).

The decisions below are correct, and there is no conflict among the circuits. An amendment to the Internal Revenue Code, adopted in 1964, resolves the issue in dispute for the future, thus eliminating any possible future significance of this case.

Negotiations for the sale of the hotel began with an offer to purchase the property for $2,800,000, on terms that called for a down payment, plus a deferred payment mortgage bearing interest at an annual rate of 4½ percent. The interest would have totalled $440,000 over the full term of the note. Petitioners countered that they would sell only at a price of $3,240,000, the sum of the purchase price and interest offered, and that the note should be made non-interest bearing. They at the same time observed that the demanded increase in price would approximately equal the interest provided for in the original offer (R. 107a–108a).

The purchaser objected on the ground that any prepayments of the debt would be penalized to the extent of such interest as would not have accrued under the terms of the initial offer. Petitioners then offered to apply a schedule of discounts in the event of prepayment. The discounts decreased with time in a manner that roughly paralleled the interest that would have been saved by prepayment under the original offer (R. 108a–109a).

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[1] "R." references are to the appendix to the brief for the appellants filed in the court of appeals.

The purchaser accepted. Following the transfer of the property, it treated $440,000 of the deferred payments as interest, and claimed deductions for them as paid. Petitioners, on the other hand, treated the same amounts as payments of principal, and claimed the preferential tax rates accorded capital gains (R. 113a).

The Commissioner, in order to protect the revenue, disallowed both claims. In a companion case brought by the purchaser, the Tax Court rejected the Commissioner's position that the payments were capital in nature, and sustained the purchaser's treatment of the $440,000 as an interest expense. *Raleigh Properties, Inc.* v. *Commissioner*, 1962 P-H Tax Ct. Mem. ¶ 62,150, reprinted at R. 5a. The present case was brought by petitioners to test their position that the payments included no such interest.

This Court has made clear that the substance of a transaction must govern its tax consequences. "[T]he transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. * * * [T]o permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334.

The transaction here at issue was in every material respect indistinguishable from one based upon a note expressly calling for interest. The entire tenor of the negotiations demonstrated that the purchasers wanted an interest-bearing transaction, the sellers acquiesced,

and the ultimate agreement contemplated interest, even though the word "interest" was not used in the documents.

Petitioners err in asserting a conflict between the decision below and those of the Fifth Circuit in *Daniel Bros.* v. *Commissioner*, 28 F. 2d 761, and *Hundahl* v. *Commissioner*, 118 F. 2d 349 (Pet. 10–12). In *Daniel* the taxpayer was entitled to a discount on prepayment of a deferred obligation only after the required periodic payments had been made for 6 years; in *Hundahl* the taxpayer was entitled to a prepayment discount only in the event of his death, or after paying for 5 years. Thus in neither case could a fair parallel be drawn to a transaction bearing interest at a set annual rate.

Congress has in any event resolved the question for the future by adding Section 483 to the Code. That provision, adopted in 1964,* requires the Commissioner to impute a reasonable rate of interest to any deferred payment transaction that on its face provides for no interest or interest at an unreasonably low rate.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JUNE 1967.

* Revenue Act of 1964, P.L. 88-272, 78 Stat. 19, Sec. 224(a).

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